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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ILLINOIS LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above case on November 26, 1935, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 29) is reported in 30 B. T. A. 1160. The opinion of the Circuit Court of Appeals is reported in 80 F. (2d) 280.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 26, 1935. The petition for rehearing was denied on January 9, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1929, on account of so-called "survivorship investment funds" and additional liability on survivorship investment policies contingent on payment of deferred and uncollected premiums, constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.[1]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 13–16.

STATEMENT

Respondent is an Illinois corporation, which, during the calendar year 1929 and prior thereto, was engaged in the business of writing and issuing

[1] Section 203 (a) (2) of the Revenue Act of 1928, c. 852, 45 Stat. 791, re-enacts without substantial change the corresponding provisions of Section 245 (a) (2) of the Revenue Acts of 1921, c. 136, 42 Stat. 227; 1924, c. 234, 43 Stat. 253; and 1926, c. 27, 44 Stat. 9.

policies of life insurance on the lives of individuals, with its home office and place of business in the city of Chicago, Illinois. (R. 13.) During and prior to the calendar year 1929, respondent issued certain so-called survivorship investment policies of life insurance, designated "20 Payment Life—Survivorship Investment Policy", a specimen copy being set forth in the record as "Joint Exhibit A." (R. 13, 14–27.) This policy calls for the payment of an annual premium of $379.90, out of which there is set aside each year (from the second to the twentieth years) the sum of $64.60 in the "survivorship investment fund." (R. 25.) This fund is accumulated at the rate of 3½ percent compound interest from the dates of the respective premium payments, and the company agrees that no deductions shall be made from said fund for any purpose whatsoever. (R. 19.) At the end of twenty years the entire survivorship investment fund in the class of policies maturing in that year is to be distributed among the members of the class *then surviving* and in good standing in proportion to their respective contributions to the fund established for that class. (See Survivorship Investment Fund (R. 19).)

At the expiration of the twenty-year life of the policy, the insured has the option of (R. 20):

> (a) Continuing his policy as a fully paid-up policy without the payment of further premiums and of receiving *in addition thereto*—

(1) A cash payment of the survivorship investment *then* apportioned to his policy, or

(2) Subject to satisfactory evidence of his then insurability, a Fully Paid-up Non-Participating Life Policy, for such amount as could be then purchased by the survivorship investment, at the company's then published single premium rate applicable at the *then* attained age of the insured; or

(b) Surrender his policy and receive—

(3) In cash the cash surrender value of his policy of $6,100, and *in addition thereto* the survivorship investment then apportioned to his policy.

After notice to the insured, if he fails to notify the company of his election within three months from the end of the survivorship investment period, optional settlement No. 1 automatically applies. (Optional Settlements (R. 20).)

Respondent's liabilities pursuant to the agreements contained in and peculiar to said survivorship policies as of December 31, 1928, and as of December 31, 1929, were as follows:

	Dec. 31, 1928	Dec. 31, 1929
Survivorship investment funds	$3,249,580.06	$3,342,162.91
Additional liability on S. I. policies contingent on payment of deferred and uncollected premiums	48,707.53	47,334.82
Total	3,298,287.59	3,389,497.73

(See Statement of Evidence (R. 13).)

Respondent in its income tax return for the calendar year 1929 claimed and took as a deduction from its gross income 4 percent of the mean of the above totals, that is, $133,755.71. (R. 13.)

The Board of Tax Appeals, four members of the Board dissenting (R. 35), sustained the respondent, holding that the amounts held at the beginning and end of the calendar year 1929, above set forth, constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928, and thereupon entered its decision in favor of respondent on the issue here involved. (R. 31–35.) The Circuit Court of Appeals affirmed the Board's decision and denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a fixed liability, which might in the future be converted into life insurance at the option of a policyholder but which had not been so converted during the tax year, is one against which a technical insurance reserve such as is contemplated by Section 203 (a) (2) of the Revenue Act of 1928, may be set up and maintained.

2. In holding that the survivorship investment fund with accumulations thereon held at the beginning and end of the calendar year 1929 constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

3. In holding that respondent's liability on account of survivorship investment funds and additional liability on account of survivorship investment policies contingent on payment of deferred and uncollected premiums, against which respondent held so-called reserves at the beginning and end of the calendar year 1929, constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

4. In holding that the legal reserves required to be maintained by respondent during the year 1929 under the laws of the State of Illinois included the amounts set aside by respondent in its survivorship investment fund, with accumulations thereon, and respondent's liabilities on survivorship investment policies contingent on the payment of deferred and uncollected premiums.

5. In failing to hold that the survivorship investment fund held by respondent, with accumulations thereon, at the beginning and end of the calendar year 1929 to meet its liabilities to the holders of its outstanding 20 Payment Life Survivorship Investment Policies did not constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

6. In failing to hold that the amount held by respondent at the beginning and end of the calendar year 1929 to meet its additional liability on survivorship investment policies contingent on payment of deferred and uncollected premiums did not con-

stitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

7. In failing to hold that the "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928 and the laws of the State of Illinois are only those held against life insurance in force and unmatured.

8. In affirming the decision of the Board of Tax Appeals and denying the Commissioner's petition for review.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the decision of this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686.

In the case at bar the only question is whether the "survivorship investment fund" set aside by the respondent, and the fund held to cover "additional liability on survivorship investment policies" are "reserve funds" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928. The Government submits that since neither fund is designed to pay life insurance, these funds are not "reserve funds."

The survivorship investment fund is set aside exclusively to pay contributors to a tontine plan. Payments from that fund are made on a principle which is the very reverse of life insurance, for they are made to those who survive, and not to the bene-

ficiaries of those who die. These payments may be made in cash. Or they may, if the survivor so elects (and if he is a satisfactory insurance risk), be made in the form of a paid-up insurance policy. But until the survivor elects, it is clear that the respondent company holds the fund as a reserve not to meet a liability for life insurance policies, but as a reserve to meet its liability to pay survivors of a tontine plan either cash or a premium on a life insurance policy.

The fund held to cover "additional liability on S. I. [survivorship investment] policies contingent on payment of deferred and uncollected premiums" (R. 13) is manifestly a mere liability of the company. It is not a life insurance reserve, because there are in existence no life insurance policies which it could cover.

In holding that these funds are insurance reserve funds required by law, the lower court has rendered a decision in direct conflict with *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686. In that case this Court held that a fund set aside by a life insurance company as a reserve for matured and unpaid coupons attached to 20-payment life coupon nonparticipating policies did not constitute a reserve fund required by law within the meaning of Section 245 (a) (2) of the Revenue Act of 1921 (which is identical with the provision of the Revenue Act of 1928 here invoked). Mr. Justice Butler pointed out (page 690) that:

The word "reserve" has many meanings. Accounts creating reserves are set up in almost every line of business, and funds evidenced by the book entries are held for many and widely different purposes. As the Act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance. In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. The premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for the discharge of coupon liability according to the terms of the policy. The coupon values are the equivalent of cash and may be used to pay premiums on the face amount of the policy, to procure additional insurance, to lessen the number of annual premiums, or otherwise to obtain insurance protection. The amounts so applied cease to exist as coupon liabilities and automatically become a part of the life insurance reserves. These differ essentially from coupon liability. Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, whereas liability on the matured coupons depends upon no contingency. It follows that the insurance reserves alone constitute the base on which the

> deduction is to be computed. Reserves against matured coupons are excluded. [Citing cases.]

Under the tests thus prescribed by this Court,[2] it is clear that the survivorship fund and the "additional liability on survivorship investment policies" involved in the case at bar are not entitled to be used as a basis for the deduction specified in the Revenue Act. It cannot be said that either fund "is attributable to and represents the value of the life insurance elements of the policy contracts". Each is attributable to the part of the premiums specially set aside to cover the tontine plan (R. 19). Here "the premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for" the tontine plan; and it is this very excess which constitutes the funds now in issue.

The lower court erroneously supposed that the *Inter-Mountain Insurance Co.* case decided that the test of whether a reserve fund could be used as the basis of a deduction was whether the liabilities to be met from that fund are or are not contingent. This is an obvious error, for the *Inter-Mountain Insurance Co.* case decided that the test was

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[2] Cf. *McCoach* v. *Insurance Co. of North America*, 244 U. S. 585; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *United States* v. *Boston Insurance Co.*, 269 U. S. 197; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109, 119, which hold that the term "reserve funds", as used in the Revenue Acts, has a technical meaning and does not include all reserves maintained pursuant to the requirements of state law or designated as such by state officials.

whether the fund is or is not designed to meet *life insurance* liabilities. The opinion of this Court emphasizes that *life insurance* reserves alone constitute the base on which the deduction is to be computed. A fund which is to meet a liability that matures only upon the survivorship of the insured is not a life insurance reserve, even though the participant in the tontine plan may elect to use his part of the fund to buy life insurance.

2. The decision of the lower court is in conflict not merely with an applicable decision of this Court, but also with two decisions of the Court of Claims. In *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, cert. den., 279 U. S. 856, it was held that reserves for deferred dividends, provisionally ascertained and held awaiting apportionment, on the company's outstanding deferred policies, and payable at the end of the tontine period to the then surviving members of the class of policyholders entitled thereto, did not constitute "reserve funds required by law" on which a tax deduction could be based. And *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474 (C. Cls.)[3] held that a tax deduction could not be calculated upon the basis of reserves to meet liabilities to holders of matured, unsurrendered and unpaid coupons.

This conflict should be resolved not alone because of the importance of the issue, but also be-

[3] This case has been cited with apparent approval by this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, at 690.

cause there are now pending in the lower courts and before the Board of Tax Appeals a number of cases in which the same problem is presented.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

APRIL 1936.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 842:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) RESERVE FUNDS.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, * * *.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84–88; and

(2) Four per cent of the mean of the reserve funds held at the beginning and end of the taxable year, without any abatement on account of tax-exempt interest. (See decision of United States Supreme Court in the case of *National Life Insurance Co.* v. *United States* (277 U. S., 508).) The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance

departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner

to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. *Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.* [Italics supplied.]

Laws of Illinois (Cahill's Illinois Revised Statutes, 1929, c. 73, par. 331, Sec. 10, p. 1542):

* * * * *

The Department of Trade and Commerce shall annually make valuations of all outstanding policies, additions thereto, unpaid dividends and all other obligations of every life insurance corporation doing business in this State. All valuations made by it or by its authority shall be made upon the *net premium* basis. The legal minimum standard for valuation of contracts issued before the first day of January, 1908, shall be the Actuaries' or Combined Experience Table of Mortality with interest at 4 per centum per annum and for valuation of contracts issued on or after said date shall be the *American Experience Table of Mortality with interest at 3½ per centum per annum.* [Italics supplied.]

* * * * *

Laws of Illinois (Cahill's Illinois Revised Statutes, 1929, c. 73, par. 375, Sec. 1 (5–c), p. 1549):

* * * that if any company shall issue any nonparticipating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such com-

pany shall furnish the Department of Trade and Commerce each year * * * a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; *which shall be carried as a distinct and separate reserve liability of the company* for the benefit of the classes of policies from the premium payments on which the sum was accumulated. *No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act*. * * * [Italics supplied.]

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